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IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

ZENITH RADIO CORPORATION, et al.,
Petitioners,

vs.

ROBERT EDWARD McGRATH,
Respondent.

IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

SUPPLEMENTAL BRIEF

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THE SEVENTH CIRCUIT'S MOST RECENT "ECONOMIC REALITIES" DECISION ESTABLISHES THE COURT'S MISAPPLICATION OF RULE 10b-5 IN THIS CASE

In a recent decision applying the "economic realities" test of *United Housing Foundation, Inc.* v. *Forman,* 421 U. S. 837, 95 S. Ct. 2051 (1975) to the sale of an entire business, a panel of the Seventh Circuit held the transaction to be outside of the securities laws. *Canfield* v. *Rapp. & Son, Inc.,* CCH Fed. Sec. L. Rep. ¶ 98,227 (July 6, 1981).[1] Both *Canfield* and *Fredriksen* v. *Poloway,* 637 F. 2d 1147 (7th Cir.), *cert. denied* ____ U. S. ____, 49 U. S. L. W. 3882 (May 26, 1981), involved an

[1] The *Canfield* decision, which was first published July 29, 1981, was unavailable at the time petitioners filed their Petition on June 19 and printed their Reply Brief, which was filed on July 31. Petitioners file this Supplemental Brief pursuant to Rule 22.6 of this Court for the purpose of calling the Court's attention to the *Canfield* decision.

allegedly defrauded purchaser of an entire business. *Fredriksen,* however, involved only an asset acquisition to which the transfer of stock was incidental. 637 F. 2d at 1144. See Resp. Br. Opp. 11-12. Even though *Canfield* involved the sale of the entire business through a stock transaction, the Seventh Circuit extended its adherence to the *Forman* rule: "We now reaffirm our holding that 'economic reality' is always the key issue." CCH Fed. Sec. L. Rep. ¶ 98,227 at 91,533.

In the instant case, although a dissenting judge found no basis for federal jurisdiction, the other two members of a third Seventh Circuit panel refused to recognize that the economic reality of the Basford transaction involved the sale of a business, not an investment in securities. The majority below distinguished *Fredriksen,* apparently solely because McGrath was a seller, not the purchaser of an entire business (Pet. App. 2b):

> "The Basford shares constituted 'securities' in the hands of plaintiff as well as the other sellers and they did not lose that status merely by reason of the fact that all the Basford shares were sold at the same time."

However, in *Canfield,* another panel of the same Court held that the transaction itself was outside the scope of Section 10(b) and Rule 10b-5.

THE MERE SALE OF STOCK DOES NOT TRIGGER APPLICATION OF RULE 10b-5

Respondent argues that the "economic reality" test comes into play only when the sale involves something other than shares of stock, as, for example, the combined stock and asset purchase in *Fredriksen* v. *Poloway,* 637 F. 2d 1147 (7th Cir. 1981) *cert. denied* 49 U. S. L. W. 3882 (May 26, 1981). However, the transaction in *Canfield* involved only the sale of stock, and the Court specifically rejected respondent's narrow view of the economic reality test. ¶ 98,227 CCH Fed. Sec. L. R. at p. 91,533 (July 6, 1981).

THE BURGEONING CONFLICT OVER THE SCOPE OF RULE 10b-5 CAN ONLY BE RESOLVED BY THIS COURT

The Seventh Circuit's opinion in *Canfield* highlights the growing divergence among opinions of the various Courts of Appeals on the scope of rule 10b-5 and the applicability of the economic reality test. One line of opinions holds that once a transaction is shown to involve stock "easily recognized as securities in the capital market" then Rule 10b-5 applies without regard to the economic realities of the transaction. *See, e.g., Coffin* v. *Polishing Machines, Inc.*, 596 F. 2d 1202 (4th Cir. 1979) *cert. denied* 444 U. S. 868 (1979). A different theory was used by one panel of the Seventh Circuit in the instant case to find that the shareholders of Basford were investors within the protection of Rule 10b-5 (Pet. pp. 1b-2b) albeit the sale agreement recited that Zenith "desires to acquire all of the assets and business of [Basford] (except the trade name and goodwill)" and that "the desires of all of the parties can best be met by a purchase by [Zenith] of all of said shares of Common Stock of [Basford] outstanding as a first step in [Zenith's] plans to develop and expand [Basford's] business." (Def. Ex. R.)

Now the Seventh Circuit holds that the economic reality test is always the key issue, and that where an entire business is bought and sold Rule 10b-5 does not apply even though the transaction is structured as a stock sale. *Canfield* v. *Rapp & Son, Inc.*, ¶ 98,227 CCH Fed. Sec. L. R. (7th Cir. July 6, 1981). The same reasoning has been applied by at least one District Court. *Anchor Darling Industries, Inc.* v. *Suozzo*, ¶ 97,933 CCH Fed. Sec. L. R. (E. D. Pa. March 16, 1981). The growing divergence of opinion over the scope of Rule 10b-5 and the applicability of this Court's economic reality test can be resolved only by this Court itself.

CONCLUSION

The most recent opinion of the Seventh Circuit in *Canfield v. Rapp & Son, Inc.*, ¶ 98,227 CCH Fed. Sec. L. R. (7th Cir. July 6, 1981) points out the increasing conflict among the Courts of Appeals and District Courts in their application of the economic realities standard and in their interpretation of the scope of Section 10(b) and Rule 10b-5. Petitioners respectfully submit that review by this Court is needed to resolve the conflict, and pray that a writ of certiorari issue to review the judgment and opinion of the Court of Appeals for the Seventh Circuit.

Respectfully submitted,

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